

**STATE OF WASHINGTON
STATE INVESTMENT BOARD**

Public Markets Committee Meeting
Minutes

October 7, 2003

The Public Markets Committee met in open public session at 1:03 P.M. at the Washington State Investment Board (WSIB) office at 2100 Evergreen Park Drive Southwest, Olympia, Washington.

Members Present:

Debbie Brookman, Acting Chair
Glenn Gorton
Jeff Hanna
Patrick McElligott
Robert Nakahara
Dave Scott

Members Absent:

Charles Kaminski, Chair
Representative Sommers

Others Present:

Joe Dear, Executive Director
Gary Bruebaker, Chief Investment Officer
Theresa Whitmarsh, Deputy Director for Operations
Nancy Calkins, Senior Investment Officer – Public Equity
Diana Will, Investment Officer – Asset Allocation
Linda Lester, Investment Officer – Public Equity
Bill Kennett, Senior Investment Officer – Fixed Income
Kristi Bromley, Administrative Assistant – Investments

Paul Silver, Assistant Attorney General

William Apfel, Walden Asset Management
Mark Cushing, Walden Asset Management
Roger Facklam, Fidelity Investments
Bill Samuels, Fidelity Investments

The meeting convened at 1:03 P.M. with Acting Chair Brookman identifying members present.

REVIEW AND APPROVAL OF MINUTES – JULY 1, 2003

Mr. McElligott moved to adopt the minutes of July 1, 2003.

Mr. Gorton seconded and the motion carried unanimously.

PUBLIC EQUITY – INTERNATIONAL EQUITY INDEX INVESTMENT MANAGER COMPETITIVE SEARCH PROCESS

Mr. Bruebaker reviewed the international equity index investment manager concept document, which is a part of the developed markets international manager searches the Washington State Investment Board is conducting as part of the international equity program structure change approved by the Board in July 2003. He stated that the contract with State Street Global Advisors (SSgA), the current international passive equity index investment manager, expires March 31, 2004. If the Board approves the concept document, staff will bring a request to the Public Markets Committee in November to extend SSgA's contract to June 30, 2004, to coincide with the expiration of the six international equity active investment managers' contracts.

Mr. Bruebaker reviewed the minimum qualifications for the search, including the minimum firm assets under management. He noted that the total assets allocated to this contract would range from \$1.7 billion to \$2.9 billion depending on the amount of assets placed in an enhanced equity structure, if any. He stated that staff believes that three firms will qualify for consideration of the contract award and said that Callan Associates (Callan) was assisting with the international developed markets manager searches. He reviewed the evaluation criteria and interview schedule and sought input from the Committee on the structure of the search process.

Discussion ensued regarding the anticipated number of qualified firms and the ability of firms to participate in both the index and enhanced index searches.

Mr. Bruebaker noted a change in the length of the contract term to five years with one five-year extension if approved by the Board. The Board would have the ability to terminate the contract at any time.

[Mr. Scott was in attendance at 1:10 P.M.]

Mr. McElligott moved that the Public Markets Committee recommend that the Board approve the international equity index investment manager concept document. Mr. Gorton seconded and the motion carried unanimously.

PUBLIC EQUITY – INTERNATIONAL EQUITY ENHANCED INDEX INVESTMENT MANAGER COMPETITIVE SEARCH PROCESS

Mr. Bruebaker presented the international equity enhanced index investment manager concept document, which is a potential part of the international program restructure with a possible allocation of up to 50 percent of the international passive allocation. He reviewed the minimum qualifications and stated that staff believes nine or more firms will qualify for this search based

on the minimum qualifications. He reviewed the evaluation criteria and the length of the contract.

Discussion ensued regarding the potential benefits of the same firm managing the index and enhanced index assets as well as the diversification risk that offsets those benefits.

Mr. McElligott moved that the Public Markets Committee recommend that the Board approve the international equity enhanced index investment manager concept document. Mr. Gorton seconded and the motion carried unanimously.

PUBLIC EQUITY – INTERNATIONAL EQUITY ACTIVE INVESTMENT MANAGER COMPETITIVE SEARCH PROCESS

Mr. Bruebaker stated that all six of the current active developed markets managers' contracts expire June 30, 2004. He reviewed the minimum qualifications and noted that the assets under management available for the new contracts are approximately \$3.5 billion. He stated that staff believes more than 108 firms will qualify based on the minimum qualifications and that screening for the desired qualifications will bring the total to approximately 63.

Mr. Bruebaker reviewed the previous Request for Proposal (RFP) process and the improvements that will be used for this search. He noted that interested firms must be in the Callan database rather than respond to a formal RFP document. There is no charge for firms to be included in the database and all they have to do is submit their information to Callan. Mr. Bruebaker said that the evaluation team will have the opportunity to consider a lot more firms this way and will use various screens to reduce eligible firms to a manageable number. Mr. Bruebaker reviewed the evaluation criteria, interview schedule, and the length of the contracts.

Mr. Gorton moved that the Public Markets Committee recommend that the Board approve the international equity active investment manager concept document. Mr. Scott seconded and the motion carried unanimously.

[The Committee recessed at 1:23 P.M. and reconvened at 1:30 P.M.]

INVESTMENT CONSULTANT POOL COMPETITIVE SEARCH PROCESS

Mr. Bruebaker stated that the current consultant pool consists of three firms: Watson Wyatt, R.V. Kuhns, and Callan. The contracts for Watson Wyatt and R.V. Kuhns expire December 31, 2003, and Callan's contract expires June 30, 2004. In July a Request for Qualifications and Quotations (RFQQ) was released for investment consultants. Mr. Bruebaker said that the response to the RFQQ was not as strong as hoped and reviewed the reasons for this: the Board's strict policy prohibiting consultants from managing money for the Board and the liability concerns some firms have. He noted that the consultants have no guarantee of business and reviewed the project assignment process. Mr. Bruebaker reviewed the responses for each consulting pool category and staff's recommendation for each.

Mr. Scott moved that the Public Markets Committee recommend that the Board approve the following consulting firms in the stated categories (Pools):

	Category	Recommended Firm
Pool A	General Investment Consulting Services	Callan Associates, Inc., Pension Consulting Alliance, and R.V. Kuhns & Associates, Inc.
Pool B1	Actuarial Studies	Aon Consulting
Pool B2	Investment Personnel Salary Surveys	Independent Fiduciary Services, Inc., and R.V. Kuhns & Associates, Inc.
Pool B3	Investment/Fiduciary Education— Workshops/Seminars	Cortex Applied Research
Pool B4	Risk Assessment and Risk Monitoring	No finalist
Pool B5	Defined Contribution Consulting	Callan Associates, Inc., and R.V. Kuhns & Associates, Inc.

Mr. McElligott seconded and the motion carried unanimously.

INTERNATIONAL INVESTMENT OPTION CHANGE

Mr. Bruebaker reported that SSgA began offering a new fund for international investments in March 2003. This fund, the T Fund, requires a turnover rate of less than 20 percent, and, as a result, has had better performance than the current international option, the A Fund. The international investment option is offered in the Teachers Retirement System Plan 3, the School Employees' Retirement System Plan 3, the Public Employees' Retirement System Plan 3, and Short-, Mid-, and Long-Horizon Funds, which are options in the Deferred Compensation Program (DCP) and Judicial Retirement Account (JRA) programs. Mr. Bruebaker said that staff has been in close contact with the Department of Retirement Systems (DRS) on this issue. Staff believes that instituting a trading restriction would result in the turnover rate going below 20 percent and every member in the international investment option would benefit from the T Fund's better performance. Mr. Bruebaker reviewed the trading restrictions and stated that market timing and daily movements negatively affect everyone else in the account.

Mr. Bruebaker also pointed out that most funds implementing such trading restrictions do it for 90 days, while we are recommending a 30-day wait period before reinvestment is permitted. He stressed that participants' ability to withdraw funds is not affected by the restriction in Fund T.

Discussion ensued regarding trading activity, notification DRS provides to members, and the prudence of this action to protect the majority of the participants from the excessive trading conducted by a few participants.

Mr. McElligott moved that the Public Markets Committee recommend to the Board that the Daily EAFE Securities Lending Fund Series A be replaced with the Daily EAFE Securities Lending Fund Series T in all appropriate programs and that a 30-day trading

restriction be implemented. Mr. Scott seconded and the motion carried unanimously.

PUBLIC EQUITY – DEFERRED COMPENSATION PROGRAM AND JUDICIAL RETIREMENT ACCOUNT MANAGER PRESENTATIONS

Ms. Calkins introduced the DCP and JRA manager presentations and noted that these manager presentations covered 8 of the 12 DCP and JRA investment options.

Walden Asset Management

Mr. Cushing and Mr. Apfel introduced themselves. Mr. Cushing summarized Walden's business including assets under management, professionals, and total staff. He noted that Walden provides investment management services for individuals as well as institutional investors and said that over a third of their business is socially responsible investing. Mr. Cushing stated that their parent company was changing its name to Boston Trust & Investment Management Company effective October 29, 2003. He stated that Walden's name would not change and there would be no impact on staff, ownership structure, or products and services provided to Walden's clients.

Mr. Cushing reviewed the three parts of Walden's investment philosophy: asset allocation, portfolio composition, and security selection. Mr. Apfel reviewed Walden's tactical asset allocation methodology, which involves quantitative work looking at relative value and economic forecasts to develop scenario based asset class returns and an asset allocation policy.

Mr. Apfel reviewed asset allocation and sector allocation as of September 30, 2003, and the equity portfolio characteristics as of August 31, 2003. He reviewed Walden's fixed income investment approach, which focuses on maturity management, sector allocation, and security selection and reviewed the fixed income sector allocation as of September 30, 2003, including duration and average corporate quality.

Mr. Cushing reviewed Walden's social screens, which are in the areas of customers (safety, quality, and integrity); employees (equal opportunity, labor relations, and benefits/wages); communities (citizenship, lending, and innovative philanthropy); and natural environment (resource use and waste generation). He noted that they avoid companies that violate these core values and favor companies that demonstrate strong social performance. He also noted that corporate governance is getting more focus.

Mr. Cushing reviewed Walden's performance for the quarter ended September 30, 2003, and reviewed reasons for the outperformance.

Discussion ensued regarding Walden's social screens.

Fidelity Investments

Ms. Calkins introduced Bill Samuels and Roger Facklam, with Fidelity Investments.

Mr. Samuels presented a market perspective for the third quarter of 2003; reviewed asset class returns as of September 30, 2003; S&P sector comparisons for the quarter, year to date, and 2002; and reviewed domestic equity style changes as of September 30, 2003, for the quarter, one-, three-, and five-year periods.

Mr. Samuels reviewed the performance of the Fidelity Equity-Income Fund, Fidelity Growth Company Fund, Fidelity Independence Fund, and Fidelity Overseas Fund as of September 30, 2003, for the quarter, year to date, one-, three-, five-, and ten-year periods. He noted a portfolio manager change in April 2003 for the Fidelity Independence Fund. He reviewed the Morningstar peer group rankings for each fund as of August 31, 2003, and reviewed quarterly highlights for each fund.

Mr. Samuels addressed recent allegations regarding certain mutual fund companies violating the Securities and Exchange Commission's forward pricing rules and "market-timing" activities and reviewed Fidelity's position on these issues.

WSIB Horizon Funds

Ms. Calkins introduced Diana Will, who presented the WSIB Horizon Funds annual review.

Ms. Will reviewed the description of the Horizon Funds, including their risk return levels and target allocation, and provided a history of the funds. She reviewed the growth of assets since September 2000, participant distribution as of September 30, 2003, and the percentage of plan assets for the DCP, JRA, and Plan 3s.

Ms. Will reviewed the total return of the Short-, Mid-, and Long-Horizon Funds versus the custom benchmarks for each, which consist of the underlying securities' benchmarks weighted appropriately by target allocation within each fund. She reviewed the performance attribution for each fund as of September 30, 2003, for the quarter, one-, and three-year periods versus the custom benchmarks and reviewed the tracking error from rebalancing as well as from the underlying securities. She also reviewed the returns of each underlying security: cash, fixed income, U.S. equity, and non-U.S. equity.

[The Committee recessed at 3:18 P.M. and reconvened at 3:23 P.M.]

[Mr. Hanna was no longer in attendance at 3:23 P.M.]

PUBLIC EQUITY – QUARTERLY WATCHLIST REPORT

Mr. Bruebaker reviewed the performance for the five firms currently on Watchlist (Dresdner RCM Global Investors, F&C Emerging Markets Limited, Fidelity Overseas Fund, Nicholas Applegate Capital Management, and Schroder Investment Management North America) for the second quarter, three-, and five-year periods ended June 30, 2003.

He stated that staff is not recommending any changes at this time but will probably make recommendations over the next few months.

PUBLIC EQUITY – BENCHMARK REVIEW UPDATE

Mr. Bruebaker reported there is no new information. It is still rumored that Wilshire is partnering with someone but nothing has been publicly announced. It does not appear that others are following Vanguard in moving to the Morgan Stanley Capital International domestic equity index. Staff will continue to update the Committee as any changes are made public.

OTHER ITEMS

There being no further business to come before the Public Markets Committee, the meeting adjourned at 3:26 P.M.